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# In Brief

## Russia's Capitalist Revolution: Why Market Reform Succeeded and Democracy Failed

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Russia has just completed its Capitalist Revolution, which brought down the system created by the Great Russian Socialist Revolution of 1917. The collapse of the Soviet Union, the end of communist dictatorship, and the termination of the Soviet command economy concluded the 20th century. Senior Fellow Anders Åslund, a leading specialist on postcommunist economic transformation, takes stock of these great events and explains why capitalism has taken root in Russia but democracy has not. This book is the first analysis of Russia's economic and political transformation from 1985, when Mikhail Gorbachev launched his reforms, until the present.

The central argument of the book is that Russia's current economic success is the result of a critical mass of economic reforms undertaken in the 1990s: deregulation, privatization, and eventually financial stabilization. From a historical perspective, it is impressive that Russia built a dynamic market economy in only seven years. The Russian financial crash of 1998 delivered the catharsis Russia unfortunately needed to adopt responsible fiscal policies. President Vladimir Putin is not the generator of Russia's current economic success but its beneficiary and custodian. He has also greatly benefited from high international oil prices.

### Why Market Reform Succeeded

Åslund argues that capitalism succeeded in Russia because critical market reforms were implemented in the brief window of opportunity in the winter of 1991–92. The Yegor Gaidar team had a clear idea of how to build a market economy. President Boris Yeltsin supported this idea and presented it with a set of policy actions to the Russian parliament on October 28, 1991. The parliament approved of his program in a nearly unanimous vote. Yeltsin appointed a government of outsiders, young academic economists, and in January 1992 the reform government unleashed reforms that were sufficiently radical to render them irreversible but insufficiently so for an early return to economic growth.

Until 1998, the economic results were poor, due mainly to the damage caused by long communist rule and an irresponsible fiscal policy. Russia maintained a vast budget deficit averaging 9 percent of GDP from 1993 to 1998. Monetary policy was beyond the control of the reformers and very loose until the end of 1993. The inflationary ruble zone persisted until September 1993. The reformers failed to persuade Yeltsin to liberalize energy prices in early 1992. As a consequence, rent seeking prevailed, and high inflation persisted until 1996. The financial crash of August 1998 eliminated barter and the excessive budget deficit, cleansing Russia's market economy. Yet, the initial package of reforms was sufficient to ensure that the market economy survived.

## **Why Democracy Failed**

Democracy failed because of the absence of any clear idea of how to build it. The brief window of opportunity when democracy could have been built was missed. Yeltsin should have dissolved the old, unrepresentative parliament within half a year after the aborted August 1991 coup, which delivered Russia's democratic breakthrough. He should have held an early founding election to stabilize Russia's democracy and disbanded the KGB. Instead, a major conflict evolved between president and parliament, and since the parliament did not really represent anything, it had no reason to compromise. Two years too late, Yeltsin dissolved the parliament, but it was recalcitrant and Yeltsin's administration inept, which caused serious bloodshed. The bloodletting stained Russia's nascent democracy.

A new constitution was adopted in a referendum in December 1993. It was democratic but suffered from numerous shortcomings. Presidential executive powers were excessive and not transparent. Powers between the federal and regional governments were not clearly divided. The Constitutional Court was weak. The parliamentary elections were not fully proportional, which left political parties feeble. The upper chamber, the Federation Council, became appointed and thus unrepresentative. Great, unregulated state powers and the weak rule of law prompted vast business funding of politics. President Putin wanted to build an authoritarian state, and with these building blocks he could easily do so in the apolitical mood of postrevolutionary stabilization.

## **Market Economy, and Renewed Democratization?**

Russia has ended up with an unusual combination of a reasonably free market economy and increasingly authoritarian politics reminiscent of the tsarist period. Åslund concludes that this situation is not likely to hold. Russia is too wealthy, educated, pluralist, and open to be so authoritarian. Either the market economy or the authoritarian rule will have to give in the not-too-distant future, and the market economic system appears much stronger than the still mild authoritarianism. Russia is likely to move toward a new wave of democratization.

The short-term concern is that a small group of KGB officers from St. Petersburg has seized control of the state and its corporations. They let inefficient giant state enterprises purchase successful private companies, and often these renationalizations are not voluntary. However worrisome these developments are, the economic results are likely to be so harmful even in the short term that the Russian leadership, which is focused on maintaining macroeconomic stability and a high growth rate of 7 percent a year, will be deterred and will correct the damage it is causing. However, such a development would be impeded if the oil price stays at \$100 a barrel.

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